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SUBJECT: GOVERNMENT PRESENTS FY 2008-2009 BUDGET OUTLINE TO
NATIONAL ASSEMBLY

REF: VIENTIANE 202

Classified By: MARY GRACE MCGEEHAN, CHARGE D'AFFAIRES A.I. REASON: 1.5
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¶1. (C) Summary. In a presentation to the National Assembly on July 7 the Minister of Finance laid out the Lao government's expectations for its FY 2008-2009 budget. The government projects a fiscal deficit 42% below that of the current fiscal year, thanks to revenues that are expected to climb almost 25% and a small rise in expenditures. The Minister stressed the government's intent to focus on centralizing customs revenues, increasing the use of electronic funds transfers, and implementing a pilot VAT project in the Vientiane capital region January 1, 2009. Much of the revenue increase is dedicated to raising government salaries and operating budgets; public capital investment, largely financed via official development assistance, is scheduled to fall slightly. The IMF representative for Laos indicated his agency believed the budget was largely sound, although the financing for the 2009 South East Asia Games remains opaque. Both the IMF and the World Bank believe the Lao government will face difficulties implementing the VAT in January. End Summary.

¶2. (U) In a presentation to the National Assembly on July 7 Minister of Finance Somdy Duangdy reported on the current fiscal outlook for Laos and sketched out the government's plans for fiscal year (FY) 2008-2009. For the first eight months of FY 2007-2008 the government reported domestic revenue collection of \$538 million and expenses of \$667 million. According to Minister Duangdy the Ministry of Finance (MOF) completed a pilot project in three provinces--Khammouan, Savannakhet, and Bolikamsay--to centralize customs and tax revenue collection and is also piloting a project to disburse government salaries using electronic funds transfers (EFT). Plans are to complete the EFT project at the central government level by the end of the current fiscal year.

2008-2009 Budget

¶3. (U) Looking ahead to FY 2008-2009 the Minister laid out a number of goals including raising government revenue 24.61% to 14.85% of GDP, lowering the percentage of revenue from timber royalties, and lowering the fiscal deficit. The government's revenue target for FY 2008-2009 is \$962 million (all numbers are based on 8593 kip=\$1), broken down as follows:

Taxes:	\$407 Million
Customs/Duties:	\$262 Million
User Fees:	\$108 Million
Revenue from State-Owned Businesses:	\$78 Million
Land Tax:	\$8 Million
Timber Royalties:	\$12 Million
Grants:	\$87 Million
Total Revenue:	\$962 Million

Expenditures are planned to increase 4.81% to \$1.158 billion, approximately 19.67% of GDP. The Minister detailed the expenditures as follows:

Salaries:	\$298 Million
Personnel Allowances:	\$85 Million
Operating Expenses:	\$121 Million
Provincial Transfers:	\$68 Million
Reserves/Contingency Funds:	\$12 Million
International Dues:	\$3 Million
Debt Service:	\$181 Million
Capital Expenditure:	\$390 Million
Total Expenditure:	\$1.158 Billion

¶4. (U) The projected budget deficit is \$196 million, 3.33% of GDP. According to the Minister, the deficit is expected to be 42% lower than in FY 2008-2009. While this is a positive development, the \$196 million deficit will be almost completely covered via lending from abroad. The government expects only \$9 million to come from domestic financing sources. Minister Duangdy noted the government intends to continue the centralization of tax and customs collection (supported by the World Bank) and expand the use of electronic funds transfers between the treasury and government entities to reduce the use of cash and limit leakage of government revenue. A pilot VAT project is scheduled to go into effect at the beginning of 2009 in the Vientiane capital region.

Government Planning to Raise Salaries, Cut Investment

¶5. (U) Salaries and allowances make up a third of the government's total budget and will rise about a third in FY 2008-2009. After the salary increase, the minimum government salary will now be approximately \$47 a month. This minimum reportedly only applies to cleaners, one percent of the government workforce. But salaries are very low overall--a Director General, the rough equivalent of a U.S. Assistant Secretary, makes about \$116 a month. Capital expenditures, money budgeted for what the GOL refers to as public investment, remain largely foreign financed--the GOL estimates that 77% of recent public investment came from official development assistance (ODA). Despite a pressing need for investment in education, health care, and infrastructure, the GOL actually foresees a 2.62% decline in public investment in the next fiscal year. Although taxes have begun streaming into the GOL's Treasury--Oxiana Mining alone reported paying \$132 million in taxes, royalties, and dividends based on 2007 results--little of the new revenue is being directed toward much-needed social and infrastructure investment.

IFI's Give Qualified Thumbs Up

¶6. (C) The IMF's Vietnam-based representative for Laos, Ben Bingham, indicated that from his agency's perspective the budget appears relatively sound and includes steps towards fiscal consolidation. However, there is some question as to whether the true cost of the 2009 South East Asia (SEA) Games are reflected in the government's budget or if the costs are being placed "off the books." The recent announcement by the Government of Laos (GOL) that the planned That Luang Marsh development (reftel) has been shrunk from 1600 to 200 hectares gives credence to the IMF's concerns. According to the Lao themselves, the Chinese agreed to finance facilities, including a large stadium, for the SEA games in return for a significant land concession. The government has publicly pledged to seek other land for the development, but if no agreement is reached the government could be forced to pay for the construction of facilities using its own funds.

¶7. (C) Both the IMF and the World Bank have doubts about the GOL's ability to begin implementing a Value Added Tax (VAT) on January 1, 2009. The Bank's senior economist for Laos, Katia Vostroknutova, said that a recent group of visiting Bank tax experts had concluded the GOL simply is not yet prepared to roll out the technically sophisticated VAT.

However, because the GOL has already previously postponed VAT implementation and wants to maintain momentum, Ms. Vostroknutova said the government will announce the VAT in January but is realistically hoping to begin implementation in October. (This will give the GOL time to train tax collectors and taxpayers.) Like Mr. Bingham, she also believes the current budget is fairly realistic.

18. (C) Comment: The proposed GOL budget is a sharp reminder of how little the central government collects and disburses relative to the needs of the country. Although it is easy to become excited about large natural resource revenue streams, what Laos really needs is more diverse growth in sectors that can provide employment for Laos' growing population and provide tax revenues. We continue to encourage the GOL to look at policies that would attract industry, encouraging them for example to provide low-cost power to manufacturers rather than selling virtually all electricity generated by hydropower projects to foreign countries, as it currently does. The current reliance on ODA to finance capital investment is unlikely to change in the near future--there is little incentive for the government to turn away what often amounts to free money. The government's emphasis on raising public sector salaries is necessary, and also unlikely to change. Setting salary structures that do not require government workers either to be self-sufficient members of wealthy families, work second jobs, or constantly seek bribes, in order to maintain an adequate standard of living, is an important step towards good governance and against corruption. Projects to centralize customs and treasury revenue collection, although just beginning, represent a welcome step towards limiting fiscal leakage into the provinces and strengthening the hand of the central government. Too often it appears as though the writ of the central government ends shortly after one leaves Vientiane, with the provincial governors operating almost autonomously.

MCGEEHAN